SQUIRE SANDERS HAMMONDS | LEGAL COUNSEL WORLDWIDE

UNITED KINGDOM TAX BULLETIN

Squire Sanders Hammonds

April 2011

www.ssd.com

SQUIRE SANDERS HAMMONDS | LEGAL COUNSEL WORLDWIDE

UNITED KINGDOM TAX BULLETIN

CURRENT RATES	April 2011
Indexation	
Retail price index: March 2011	232.5
Inflation rate: March 2011	5.3%
Indexation factor from March 1982:	
to April 1998	1.047
to February 2011	1.912
to March 2011	(not yet announced)

Interest on Overdue Tax

Interest on all unpaid tax is charged at the same rate.

The formula is Bank base rate plus 2.5% which gives a present rate of 3%.

There is one exception: Quarterly instalments of corporation tax bear interest at only 1.5%.

Repayment Supplement

Interest on all overpaid tax is payable at the same rate.

The formula is Bank base rate minus 1% but with an overriding minimum of 0.5% which applies at the present time.

Official Rate of Interest: From 6 April 2010 4%

Residence: Full-Time Employment

It may be remembered that HMRC have recently confirmed their practice that a person may become non-resident (without the need to make any distinct break, sever their family or social ties or anything else) if they leave the UK to work full time abroad, providing the work lasts for at least a whole tax year and their visits to the UK do not exceed 90 days on average during their period of absence.

It is obviously very important to identify the meaning of "full-time work abroad" in this context, and HMRC have now published their revised view on the subject. Appropriate amendments are to be made to HMRC6. The following points are helpful:

- It must be a genuine full-time employment – possibly with a foreign employer or a formal secondment to a non-UK position of a UK employer.

- It needs to involve working equivalent hours to full-time foreign employees at the same level and in the same line of business in the country concerned. As a general rule HMRC will expect this to be 35 hours per week. (It is curious that this is a different test from that which has been applicable to a "full-time working employee" for various other tax purposes where only 75% of the normal working week is required. Anyway, this new practice is clear and will apply in questions of residence.)

- An employment which involves full-time work abroad obviously precludes any work in the UK, but where duties performed in the UK are "merely incidental" to the main overseas duties, they have always been disregarded. This is not only a matter of practice. It also features as part of Section 830 ITA 2007 (formerly Section 335 TA 1988) where incidental duties are to be disregarded. Incidental duties have been understood to be those which have no substantive function but are merely ancillary to the overseas duties. However, attending board meetings in the UK has never been regarded by HMRC as merely incidental to the work done overseas no matter how short those visits to the UK may be.

The latest HMRC guidance is intended to clarify their approach relating to the meaning of full-time work abroad. It is interesting that it does not affect the interpretation of incidental duties.

HMRC say that they have had a practice whereby UK duties are disregarded even though they are more than merely incidental. As a general rule, they will accept that working in the UK for fewer than 10 days a year (not just on incidental duties) will not interfere with the requirement for working full time abroad. If more days are worked in the UK, the question will need to be decided on other grounds.

HMRC confirm that for 2011/12 this practice "will continue", although of course it will need to be reviewed in the light of the proposed statutory residence test.

I think this may come as a surprise to many people. I have never heard of such a practice, and HMRC acknowledge that it is contrary to the statutory position. Whilst such a relaxation is welcome and we should not look a gift horse in the mouth, it is regrettable that they should adopt such an extra-statutory approach while insisting loudly that they do not and cannot do so. I think that Mr Ogden (see below) will have a really justifiable grievance.

It should be recognised that this 10-day rule does not apply to people who are already resident abroad. It is merely a rule of thumb in determining whether somebody has become non-resident under the full-time working abroad test and has no relevance to the position of somebody who visits the UK for the purpose of their work. They are subject to the normal 90-day test in HMRC6.

Exceptional Days in the UK

Whilst on the subject of residence, nobody could fail to have sympathy for Mr Ogden (*Nicholas Ogden v HMRC* TC 1077). His case may have been doomed in technical terms, but nevertheless it was a shame (to say the very least) that nothing could be done.

Mr Ogden lives and works abroad and has done so for many years. In early 2002 his son was admitted to Papworth Hospital in Cambridge for a heart and lung transplant. In August 2002 he took compassionate leave from his employer to be with his son in hospital. His son died in October, but when he returned to work he was fired from his job without warning and received a substantial compensation payment. Unfortunately, he had been in the UK for more than 183 days in 2002/3, although the majority of those days were of course the result of wholly exceptional circumstances which he thought should be disregarded under the HMRC's well established practice in IR20. HMRC said that the whole of his earnings and compensation payment were therefore taxable.

Unfortunately, the practice relating to exceptional circumstances applies only to the situation where the total days in the UK are less than 183. HMRC said that above that threshold, the law was clear and there was no opportunity to use the exclusion for exceptional circumstances.

HMRC expressed sympathy for Mr Ogden's position, but there were no exceptions to the law and HMRC had no discretion to create any such exceptions. Funny how they manage to do so when they feel like it.

Employee Benefit Trusts: Settlement

HMRC has published a statement offering employers who have used EBTs an opportunity to come to a settlement with HMRC. This sounds good – until you read it.

HMRC say that in the majority of cases the contributions to the employee trust have a link to the employment. If no relevant step under the (proposed) disguised remuneration legislation has been taken, HMRC will settle

on the basis that the whole of the PAYE and NIC is paid plus interest. If an employee has paid any tax on a benefit in kind (e.g., on a beneficial loan), credit for that tax will be allowed.

However, if a relevant step has already been taken, HMRC will require all the tax and NIC to be paid plus interest, but with no (or a reduced) credit for any benefit in kind tax paid. Whilst one understands that HMRC regard EBTs with great hostility, and they have no wish to afford any generosity to those involved, this statement does not seem to offer much by way of incentive to unravel the arrangements.

Extra-Statutory Concession A10

This concession gives relief from tax on a lump sum received from an overseas pension scheme where all or part of the lump sum relates to duties performed outside the UK while the individual is non-resident. HMRC are withdrawing this concession in respect of lump sum benefits provided by third parties which fall within the new disguised remuneration legislation. The concession will be replaced by “a just and reasonable reduction in the amount of employment income chargeable to tax”.

The concession will continue to apply to benefits which accrued to employers before 6 April 2011 whenever the lump sum is paid. The lump sum will be apportioned between the two periods with only the part of the lump sum paid in respect of rights accruing before 6 April 2011 being relievable or exempted by the concession.

The concession will continue to apply unchanged to the payment of lump sum benefits which do not fall within the disguised remuneration legislation, and it is expected that the concession will be put on a statutory footing before very long.

EBTs: Inheritance Tax and Income Tax

HMRC have issued a new brief (18/11) setting out their view of the inheritance tax and income tax implications of contributions to an EBT by a close company. Under the circumstances, this seems like overkill because I cannot imagine there will be many more of those having regard to the new legislation. However, the key sentence is probably the one in which they say that existing cases will be taken forward by HMRC on the basis of this new statement.

These thoughts are not new; they issued a very similar statement in 2009 which, in the view of many, seriously overstated the inheritance tax position.

HMRC argue that contributions to an EBT are chargeable transfers which can be attributed to participators under Section 94 IHTA 1984. There are a few problems with this interpretation – namely Section 10 (which excludes transfers which are not intended to confer a gratuitous benefit), Section 12 (which provides protection from a charge of inheritance tax if the contribution is allowable in computing the profits of the

company for corporation tax purposes) and Section 13 (which exempts any contributions from IHT if the participators in the company are excluded from any benefit under the EBT).

The purpose of the statement is to explain HMRC's view that generally none of these exemptions apply. While HMRC may well be able to challenge some EBTs successfully on those grounds, it is a bit excessive to suggest that this will generally be the case. I would suggest that in most cases one of the exceptions will quite properly apply. This is really important because if the exemptions do not apply, the transfer to the EBT is treated as a transfer value made by the participators and subject to the lifetime charge of 20%.

As far as Section 10 is concerned the transfer must not be intended to confer a gratuitous benefit on any person. Furthermore, the transaction must be such as might be expected in a transaction at arm's length between persons not connected with each other. The whole idea of an EBT is to provide benefits to employees which is a *bona fide* commercial purpose. This is exactly the sort of transaction which is made between unconnected persons, and there is nothing gratuitous about it. That was exactly the position in *Postlethwaite* where HMRC failed with this argument.

They say that the Section 10 test is not met if there is the slightest possibility of gratuitous intent at the date the contribution is made. That must surely be an exaggeration. Furthermore, they go on to say that to satisfy the conditions of Section 86 IHTA 1984, the trustees' discretion must remain unfettered. There is nothing in Section 86 which requires the trustees' discretion to be unfettered, and these are just additional conditions introduced by HMRC.

As far as Section 12 is concerned, this provides an exemption from the charge of inheritance tax if the contribution to the EBT is allowable for corporation tax. The general rule is that contributions are allowable by the company only when they are paid out to employees and chargeable to tax and NIC on them. There is no particular time specified in Section 12. All it says is that the contribution is not a transfer of value "if it is allowable in computing [the company's] profits or gains for the purposes of corporation tax". If for some reason the deduction is deferred until the following year because of the delay in paying it out to the employees, that would not make the contribution disallowable – quite the contrary, the legislation provides that the contribution is allowable in a later year. However, HMRC take the view that Section 12 applies only to the extent that a deduction is allowable in the year in which the contribution is made. This too is clearly an exaggerated view and must surely be overstating the position. (I wonder what happens in circumstances where a contribution is made, an inheritance tax charge is imposed and the corporation tax deduction is allowed in the following year. Perhaps there is a revision of the earlier chargeable transfer. In your dreams.)

There is also some discussion regarding the availability of business property relief. However, all HMRC say is that business property relief requires the transfer to meet all the relevant conditions. Well, yes. It does not offer any guidance on the matter. (However, there must be a possibility that even a cash transfer to an EBT could qualify for business property relief on the principle established in *Nelson Dance*.)

The statement also extends to income tax and the transfer of assets abroad legislation (which used to be Section 739 and Section 740 ITA 1998). If there is a transfer of assets by virtue or in consequence of which (perhaps together with associated operations) income becomes payable to a person resident abroad, and the transferor has power to enjoy the income, the income can be attributed directly to him.

The difficulty here is that most of the time an offshore EBT will be a normal commercial arrangement to reward its employees and the transferor will be the employer company, thereby excluding the application of these provisions. However, one can envisage circumstances whereby an individual could be a transferor to bring this legislation into play. HMRC are not very specific about the position, but they are just putting down a marker, which is fair enough.

The charging provisions under Section 740 (now Section 732 ITA 2007) are easier for HMRC to apply because any person benefitting from the EBT can be charged tax on the income by reference to benefits received from the EBT. There is no requirement for him to be a settlor, a transferor or anything else. However, there is still the *bona fide* commercial exemption which is likely to reduce the possibility of a charge tax on this basis.

I suppose all the EBT stuff is no surprise. HMRC clearly hate EBTs with a vengeance and are doing everything they can to outlaw them – and to penalise anybody who has had anything to do with one. Some may feel that this has become a bit obsessive.

Group Structures: IHT

Some correspondence with CIOT and HMRC has recently been published relating to the availability of business property relief for shares in a holding company of a group of companies. A difficulty in the interpretation of Section 105 IHTA 1984 has put the availability of business property relief in doubt, and HMRC have provided some very helpful clarification on the issue.

A typical situation would be a holding company whose main activity is holding shares in its trading subsidiaries but which has also made loans to the trading subsidiaries. The question is whether the business of the holding company consists wholly or mainly in being a holding company of trading subsidiaries or whether the existence of the loans is a separate business which disqualifies it from the relief. However, if the business of being a holding company is a wider concept than merely holding shares, and includes the provision of loan finance to subsidiaries, then the relief would not be put in danger by the provision of such loan finance.

HMRC have confirmed their agreement with this interpretation, taking the view that holding shares, providing loan and other finance, providing strategic direction and coordination of the subsidiaries, and a whole host of other things are within the normal scope of the business of a holding company, thereby confirming that business property relief should be available in most cases.

By Reason of Employment

The recent case of *Rogers v. HMRC* TC 1036 concerned a transfer of shares from a major shareholder to a senior employee and whether it was taxable as a reward for services or not taxable being in the nature of a testimonial. This is a very fine distinction indeed – there are numerous cases each way.

Mr Rogers had been extremely successful in developing the business of his employer company, and he had been trying for years to acquire shares in the company. Eventually he secured a promise from the major shareholder to allow him to buy some shares, for which he expected to pay full value. Unfortunately the major shareholder was killed in an air accident, but his father, being aware of his son's wishes, caused 9% of the company to be transferred to Mr Rogers for a nominal value in 2002. This was voluntary, and under the circumstances rather unexpected, although this does not necessarily make it tax free. The question was whether the acquisition by Mr Rogers of these shares was a reward for his services. Having regard to the extensive evidence of his skills and how he had enhanced the company's business, clearly HMRC had an argument. However, it is relevant that the shares were transferred to him not by his employer, but by the major shareholder. This is really important because under Section 168 TA 1988 a benefit provided by the employer was deemed to be by reason of the employment.

The Tribunal decided that the transfer of the shares was a gratuitous transfer reflecting the shareholders' gratitude for the role which Mr Rogers had played in building up the company's business and did not arise from Mr Rogers' employment. It was therefore in the nature of a testimonial. The employment was not the active cause of the transfer of the shares.

It is not difficult to see that this reasoning could quite easily support a different conclusion.

These arguments are unlikely to be available any more because ITEPA 2003 recast the terms of Section 168, and any right or opportunity to acquire securities is now regarded as occurring by reason of his employment if it is made available by his employer, or by a person connected with his employer. It is fortunate that Mr Rogers' transaction took place in 2002.

Hidden in the depths of this case was a statement that "payment" for the purposes of the PAYE regulations did not apply to the transfer of an asset and required payment in money. I understand this view to be consistent with the Companies Act provisions relating to companies purchasing their own shares where payment means money and cannot be satisfied by the provision of a non-cash asset. However, in 2008 in the case of *Irving v. HMRC*, the Court of Appeal decided that "pays a sum" did not mean just payment in money but included the transfer of non-cash assets. This was in the context of a payment to a pension scheme for an employee, and the Court of Appeal said that the distinction between these two funding methods made no commercial sense and could not reflect any legislative policy.

I just wish they would make up their minds.

Ramsay Doctrine

It is very boring to go banging on about Ramsay as it has little practical relevance to day-to-day tax practice, but the case of *HMRC v. Mayes* in the Court of Appeal is of genuine interest.

Mr Mayes entered into a tax scheme, but whether the scheme worked does not really matter. The point is that the Ramsay doctrine has got all muddied up recently and it is good to have a clear statement about it by the Court of Appeal. It has long been the source of some dissatisfaction that the Ramsay doctrine has been hailed as a principle of statutory construction – but somehow it never applies to the taxpayer. It is only ever used as a means of allowing HMRC an interpretation which is at variance with the apparent meaning of the statutory provisions. When the interpretation of HMRC is clearly at variance with the statutory provisions, this principle of statutory construction seems never to be applicable. Maybe things are changing.

The tax avoidance scheme related to second-hand insurance policies. The provisions relating to these policies are desperately complex and can quite easily give rise to a taxable gain when no real gain exists. HMRC do not complain about that. However, where it gives rise to an allowable tax loss where no real loss exists, they start to get excited. It was the very complexity of the rules which meant that the Ramsay principle could not be applied. In the High Court it was said that:

> *This is legislation which does not seek to tax real or commercial gains. Thus it makes no sense to say that the legislation must be construed to apply to transactions by reference to their commercial substance.*

Although the Court acknowledged that there is an instinctive reaction that such schemes should not succeed, that was not a reason to dispense with their responsibilities to the rule of law. The following passages are of considerable significance to legal interpretation in tax matters generally:

> *Ramsay did not lay down a special doctrine of revenue law striking down tax avoidance schemes on the grounds that they are artificial composite transactions and that parts of them can be disregarded. The Ramsay principle is the general principle of purposive and contextual construction of all legislation. ICTA is no exception and is not immune from it.*
>
> *One reaction, based more on academic reflection rather than on gut reaction is that neither justice nor reason has any place in tax law, which more than any other branch of municipal law is open to the reproach of being utterly incomprehensible by the individuals affected and even more frequently by their legal advisors.*
>
> *If the taxpayer succeeds and HMRC and Parliament do not like the result, the law can be readjusted for the future in a Finance Act preceded by a public debate and passed by a democratic legislative process. Even if the courts do not like the result they have no means at*

> *their disposal to amend a law enacted by Parliament. Their sole function is to decide the case on their best understanding of the relevant transactions and the applicable law whatever that may be. Whether or not the courts approve the outcome is beside the point.*
>
> *I doubt very much whether since Mawson, it really is necessary to return each time to the base camp in Ramsay and trek through all the authorities from then on. For practical purposes it should in general be possible to start from the position stated in the unanimous report of the Appellant committee in Mawson … Mawson was obviously meant to be a significant judicial stock taking of the new approach to the construction of revenue statutes.*

This looks like a really helpful summary of the present position.

Section 20 Notice: Possession or Power

A most alarming decision has just been issued by the First Tier Tribunal in the case of *Parissis v HMRC* TC 1083 concerning what is meant by documents in the possession or power of the taxpayer in Section 20 TMA 1970. This section allows the Inspector of Taxes to issue a notice requiring a person to deliver to him documents which are in his "possession or power".

Mr Parissis drew attention to the House of Lords decision in *Lonrho* in 1980 in which their Lordships said that the term "power" must mean:

> *a presently enforceable legal right to obtain from whoever actually holds the document inspection of it without the need to obtain the consent of anyone else.*

That seems pretty clear, so it is a bit of a surprise that the First Tier Tribunal decided that:

- no enforceable legal right was necessary;
- the need to obtain the consent of someone else did not matter; and
- a document is in somebody's power even if it is in the possession of another person who had a legal right to refuse to produce it.

One of the reasons for reaching these conclusions was that in the House of Lords, their Lordships were considering the Rules of the Supreme Court and the expression "possession, custody or power", whereas the Tribunal was considering Section 20 TMA 1970 and the expression "possession or power"; obviously this is completely different.

It does seem to defy any normal use of language to suggest that a document is in my power if it is in the possession of somebody else and I have no power to compel them to give it to me. This would normally be how you would describe something not being in my power. One can have sympathy for Mr Parissis because

they said he should have asked those who had the document and been refused. He did not even ask, and therefore he was liable to a penalty. This seems a bit tough by any standard. He might well have said, "The House of Lords decided this is not in my power, and although you may take a different view from that of the House of Lords, you can hardly penalise me for working on the basis of their judgment".

There is a clue here to the possible underlying reasoning of the Tribunal. It is a bit like a 13th chime. The documents required by HMRC were documents held by trustees of an offshore trust who had no legal obligation to provide any of the documents to the taxpayer. The Tribunal said that as the taxpayer had transferred some of his wealth to the trustees, he was "unlikely to do this if he did not believe that the trustees would act on his instructions". Any trust practitioner will recoil at these words and might therefore wonder about the reasoning in the judgment generally.

If there is no appeal and this judgment stands, it is clear that HMRC will be entitled to ask for almost anything and put the onus on the taxpayer of trying to obtain it even from people who will not provide it. They will have to go to all the trouble of having their request refused. At least the Tribunal did not go so far as to say that taxpayers should take legal action against third parties for the production of documents requested by HMRC if such legal action is likely to fail. But what if such legal action is evenly balanced and might succeed? Does the taxpayer have to spend substantial sums suing third parties for documents in foreign jurisdictions in order to satisfy a request by HMRC for documents which may or may not have any bearing on their tax position? I sincerely hope we will hear a lot more about this.

Peter Vaines
Squire, Sanders & Dempsey (UK) LLP
28 April 2011

SQUIRE SANDERS HAMMONDS | LEGAL COUNSEL WORLDWIDE

UNITED KINGDOM TAX BULLETIN

Contact:

Peter Vaines
+44.20.7655.1770
peter.vaines@ssd.com

Subscription Information

Squire, Sanders & Dempsey (UK) LLP publishes on a number of other topics. To see a list of options and to sign up for a mailing, or to correct or update information, visit **www.ssd.com/subscribe**.

Published by:

Squire, Sanders & Dempsey (UK) LLP
7 Devonshire Square
London
EC2M 4YH

Beijing
Berlin
Birmingham
Bratislava
Brussels
Budapest
Cincinnati
Cleveland
Columbus
Frankfurt
Hong Kong
Houston
Kyiv
Leeds
London
Los Angeles
Madrid
Manchester
Miami
Moscow
New York
Northern Virginia
Palo Alto
Paris
Phoenix
Prague
Rio de Janeiro
San Francisco
Santo Domingo
São Paulo
Shanghai
Tampa
Tokyo
Warsaw
Washington DC
West Palm Beach

Independent Network Firms:
Beirut
Bogotá
Bucharest
Buenos Aires
Caracas
La Paz
Lima
Panamá
Riyadh
Santiago

www.ssd.com